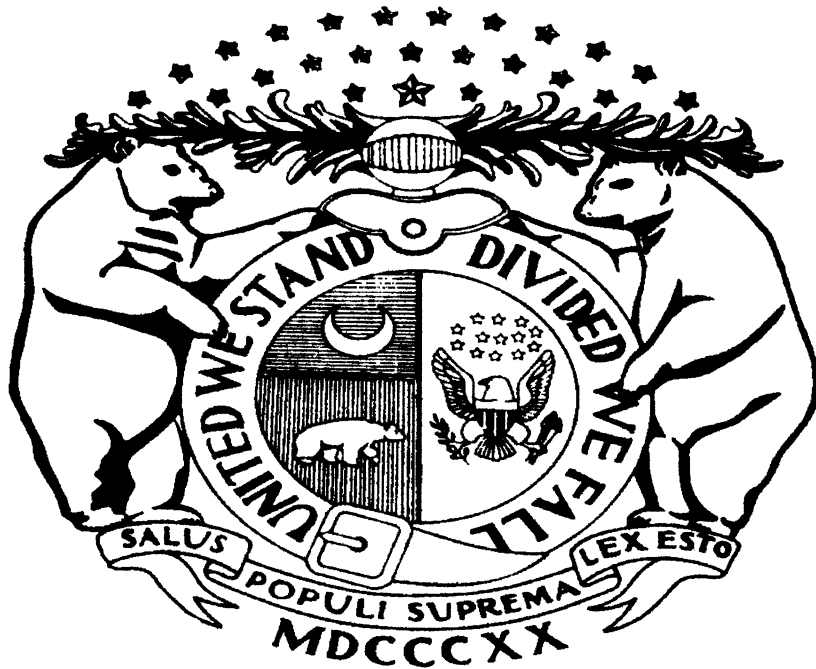


REPORT OF
ASSOCIATION FINANCIAL EXAMINATION
DENTAL SOURCE OF MISSOURI AND KANSAS, INC.

AS OF
DECEMBER 31, 2004



STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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Kansas City, Missouri
August 12, 2005

Honorable Kevin M. McCarty, Commissioner
Office of Insurance Regulation
Florida Department of Insurance
Chairman, (E) Financial Condition Committee

Honorable Jorge Gomez, Commissioner
Wisconsin Department of Insurance
Midwestern Zone Secretary

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

Dental Source of Missouri and Kansas, Inc.

hereafter referred to as such, as the "Company" or as "DSMK." Its administrative office is located at 9091 State Line Road, Suite 101, Kansas City, Missouri 64114, telephone number (816) 523-8900. This examination began on May 25, 2005, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of Dental Source of Missouri and Kansas, Inc. was made as of December 31, 2001, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) with no other zones participating.

The current full scope association financial examination covers the period from January 1, 2002, through December 31, 2004, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the NAIC, with no other zones participating.

This examination also included the material transactions and/or events occurring subsequent to the examination date which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information and workpapers supplied by the Company's independent auditor, BDO Seidman, LLP, of Houston, Texas, for its statutory audit covering the period from January 1, 2004, through December 31, 2004. This information included, but was not limited to, fraud questionnaires and narrative descriptions of processes and controls.

Comments – Previous Examination

Listed below are the comments and recommendations of the previous examination report, dated as of December 31, 2001, and the subsequent response or action taken by the Company.

Capital Stock

Comment: The Company was directed to cancel all stock certificates transferred as a result of the 1998 acquisition of the Company by Dental Economics, LP and issue a new stock certificate to the sole shareholder.

Company's Response: The Company was under the impression this had been accomplished in 1998. A new certificate was prepared on July 29, 2002, to reflect the transfer in ownership to Dental Economics, LP.

Current Finding: The stock certificate has been properly updated to reflect the Company's current ownership.

Summary of Comments-Previous Examination

Comment: The Company was ordered to ensure all comments, recommendations, or violations of any law or regulation mentioned in the "General Comments and/or Recommendations" section or referred to elsewhere in the examination report were fully addressed and implemented within the required time period imposed by the MDI.

Company's Response: The Company intends to address all comments and/or recommendations referred to in the examination report.

Current Finding: The Company failed to fully implement several of the recommendations noted in the prior examination report. The unimplemented recommendations are noted in the various sections of this report.

Conflict of Interest

Comment: The Company was directed to ensure that all directors, officers and key employees complete a conflict of interest disclosure statement on an annual basis.

Company's Response: The Company will have all directors, officers and key employees complete a conflict of interest disclosure statement on an annual basis.

Current Finding: Conflict of interest statements were completed annually for the period under examination.

Corporate Records

Comment: The Company was directed to restate and properly certify its Bylaws to include changes approved in the August 26, 1996, shareholder meeting minutes and to disclose the correct location of its principal office.

Company's Response: A copy of an Amendment to the Bylaws approved by the Board of Directors reflects the change in address for the Company's principal office.

Current Finding: The Company has still not changed its Bylaws to reflect the changes approved in the August 1996 shareholder meeting. See the Corporate Records section of this report for recommendations.

Comment: The Company was directed to ensure all material corporate transactions and events of the Company were brought to the attention of and approved by the shareholders and/or Board of Directors in a timely manner and properly documented in the corporate minutes.

Company's Response: DSMK fully intends to have all material transactions and events of the Company brought to the attention of and approved by the shareholder and Board of Directors in a timely manner.

Current Finding: It was noted the minutes of the Board of Directors and the Written Consents of the Sole Shareholder did not properly reflect and approve all material corporate transactions and events of the Company occurring during the examination period. See the Corporate Records section of this report for recommendations.

Holding Company, Subsidiaries and Affiliates

Comment: It was recommended the Company amend its Management Contract for the purpose of lowering the management fee to a level that would more reasonably compensate Dental Economics, LLC for any services provided or revise the contract to better illustrate the services provided.

Company Response: The Company's position with respect to the recommendation contained in the examination report remains the same. The management fee was set at the greater of \$50,000 or 25 percent of gross revenue as a ceiling. Management intends to safely remain within the statutory requirement as it relates to capital and surplus; however, the parent does not wish to incur federal income taxes at the subsidiary level when it can be used to offset losses at the parent company level. Dental Economics, LP personnel have spent and continue to spend an extraordinary amount of time and resources with respect to the management of DSMK and believe the management fees paid by DSMK to its parent are fair and reasonable.

Current Finding: The management fees paid continue to appear to be excessive and increased significantly during the current examination period. See the Intercompany Transactions section of this report for recommendations.

Fidelity Bond and Other Insurance

Comment: It was recommended the Company immediately acquire directors' and officers' liability and errors and omissions liability insurance to adequately protect itself from potential claims.

Company Response: DSMK is still in the process of researching directors' and officers' liability and errors' and omissions' liability insurance, and as of this date, has not yet found a cost effective policy that is reasonable considering the potential risk to the Company. DSMK will continue to explore coverage that is cost effective and not an unreasonable burden to the balance sheet.

Current Finding: The Company has not obtained adequate directors' and officers' liability or errors' and omissions' liability coverage. See the Fidelity Bond and Other Insurance section of this report for recommendations.

Provider Contracts

Comment: The provider agreements used by the Company to provide service under its dental plans were not filed with the MDI as required by Missouri Regulation 20 CSR 400-8.200, (Procedures for the Filing of All Policy Forms and Certain Rates for Life or Health Policies, Contracts or Related Forms). The Company was directed to ensure that all policies, contracts and related forms are filed with the MDI in accordance with Missouri Regulation 20 CSR 400-8.200.

Company Response: DSMK acknowledges that all required contracts, policies and forms are being filed with the MDI, and it will comply with such regulations to do so in the future.

Current Finding: The Company did file two of its provider agreements for approval with the MDI. However, the Company failed to file its Dentist Free Access Plan Contract or Specialist Free Access Plan Contracts for approval. See the Provider Contracts section of this report for recommendations.

Grievance Procedures

Comment: The Company failed to maintain and document in a centralized complaint register the total number, type, nature and results of all grievances, complaints or issues involving its members. Thus, it was recommended the Company maintain and document in a centralized complaint register, all grievances, complaints or issues involving its members.

Company Response: The Company has started maintaining a centralized electronic log of the internal complaint register that shows the member, type, nature, and result of all grievances, complaints or other issues involving members.

Current Finding: The Company is maintaining a centralized complaint register which documents the recommended information.

Internal Control System

Comment: The Company was directed to develop and implement adequate procedures and controls to ensure premium receipts were posted in a timely manner. In addition, the Company was directed to establish a general ledger escrow/suspense control account for the purpose of comparing and reconciling escrow/suspense funds with a detail listing.

Company Response: Premium receipts will be posted in a timely manner prior to month-end. Due to the volume of policyholders associated with some larger self-billed groups, individual posting will normally take an additional couple of days to complete. The monthly deposit report will be reconciled to the general ledger and bank statement each month-end to ensure accuracy. A detailed listing has been established for the purpose of comparing and reconciling escrow/suspense funds at each month-end. This amount is tracked on a monthly basis as an offset to the outstanding premiums due and unpaid.

Current Finding: Premium receipts were posted timely. The Company has established an escrow/suspense account; however, the Company incorrectly reported the account as an “Aggregate write-in for other liabilities” on the Annual Statement. The escrow/suspense account should have been reported on the “Remittances and items not allocated” line of the Annual Statement. See the Accounts and Records section of this report for recommendations.

Bonds

Comment: A certificate of deposit and several long-term bonds owned at December 31, 2001, were incorrectly classified. The Company was directed to ensure that its Annual Statement is completed in accordance with NAIC Annual Statement instructions.

Company Response: U.S. Treasury Notes have been reclassified for presentation purposes from other long-term invested assets to bonds per the request of the MDI for all future filings.

Current Finding: The Company correctly classified its certificate of deposit and long-term bond on the 2004 Annual Statement.

A&H Premiums Due and Unpaid

Comment: The Company was directed to ensure that the amount reported on behalf of the Annual Statement line item “Accident and health premiums due and unpaid” at any particular valuation date does not consist of outstanding premiums attributable to coverage periods effective in subsequent periods.

Company Response: DSMK has complied with the agreement reached with the MDI concerning revenue recognition and the proper asset/liability balances which will result.

Current Finding: The Company no longer includes outstanding premiums attributable to subsequent coverage periods in the “Accident and health premiums due and unpaid” line of the Annual Statement.

Mobile Dentistry Note Receivable and Acquisition Costs-Safeguard

Comment: The Company was directed to refrain from reporting as an admitted asset on its balance sheet, those items that did not meet the criteria and definition of an asset as defined by Missouri Regulation 20 CSR 200-1.050 (Financial Standards for Prepaid Dental Plans). In addition, the Company was directed to ensure in instances where specific statutory accounting guidelines are absent or where doubt existed as to the propriety of a special accounting method, the Company obtain prior written approval from the MDI before admitting the asset.

Company Response: DSMK still contends that the Mobile Dentistry note was allowable as an admitted asset per its interpretation of Missouri regulations; however, since the amount in question was collected in 2002, the issue is no longer relevant. The MDI has agreed to allow DSMK a 5-year amortization of the Safeguard acquisition costs. The cumulative difference

between the 10-year amortization allowed for SSAP guidelines and the 5-year amortization allowed by the MDI is reflected in the Notes to the Financial Statements. DSMK will obtain prior written approval from the MDI going forward to allow for the amortization of all intangible assets.

Current Finding: The amortized cost of the Safeguard acquisition is being reported based on a 5-year amortization period as agreed to by the MDI. There were no admitted assets reported by the Company which did not appear to meet the criteria and definition of an asset as defined by Missouri Regulation 20 CSR 200-1.050.

General Expenses

Comment: The Company failed to accrue a liability for unused vacation leave earned by its employees and was directed to implement the necessary procedures and controls to ensure adequate provisions were made in its financial statements with regards to its obligations for services, privileges or expenditures applicable to the current year but unpaid at year-end.

Company Response: The Company vacation policy was changed effective August 1, 2002, to disallow any carryover of vacation time from one year to the next. Therefore, no future liability should exist for unused vacation leave.

Current Finding: Due to the changes made in the Company's vacation policy, an accrual for unused vacation leave was not necessary.

HISTORY

General

Dental Source of Missouri and Kansas, Inc. was incorporated on December 21, 1989, and commenced business on January 1, 1990, under Chapter 354 RSMo (Health Services Corporations-Health Maintenance Corporations-Prepaid Dental Plans). DSMK is a prepaid dental plan that provides dental memberships to groups and individuals in Missouri and Kansas.

On June 5, 1998, DSMK was purchased by Dental Economics LLC, a Texas company, pursuant to the terms and conditions of a Stock Purchase Agreement. On June 26, 1998, Dental Economics, LLC entered into an agreement with Dental Economics, LP whereby 100 percent of its ownership interest in DSMK was assigned to Dental Economics, LP. Simultaneous to the

acquisition of DSMK, Dental Economics, LP also purchased Corporate Dental Care, Inc., a Missouri domiciled prepaid dental plan, and merged its operations into the surviving entity of DSMK.

Effective January 1, 2005, the ownership of DSMK was transferred from Dental Economics, LP to First Continental Life & Accident Insurance Company (First Continental), a newly acquired insurance subsidiary of Dental Economics, LP.

Capital Stock

The Company is authorized to issue 50,000 shares of \$1 par value common stock. As of December 31, 2004, all 50,000 authorized shares were issued and outstanding for a common capital stock balance of \$50,000. The Company's direct parent, Dental Economics, LP owned all outstanding common stock shares as of December 31, 2004.

Effective January 1, 2005, all outstanding shares of common stock in DSMK were transferred by Dental Economics, LP, to its newly acquired insurance subsidiary, First Continental Life & Accident Insurance Company, and thus, First Continental became the direct parent of DSMK.

Dividends

No dividends were declared or paid by the Company during the period under examination.

Management

The management of DSMK is vested in a Board of Directors that are appointed by the sole shareholder. The Company's Bylaws specify the Board of Directors shall consist of three

members. The members of the Board of Directors serving at December 31, 2004, were as follows:

<u>Name and Address</u>	<u>Business Affiliation</u>
James A. Taylor Richmond, Texas	President and Treasurer Dental Source of Missouri and Kansas, Inc.
Christopher S. Gaffney West Newton, Massachusetts	Managing Partner Great Hills Partners, LLC
George C. Kopp, III Prairie Village, Kansas	Vice President Dental Source of Missouri and Kansas, Inc.

Pursuant to its Bylaws, the officers of the Company shall consist of a President, one or more Vice Presidents, a Secretary, a Treasurer and such other officers as the Board of Directors may deem appropriate. Officers serving as of December 31, 2004, were as follows:

<u>Name</u>	<u>Office</u>
James A. Taylor	President and Treasurer
George C. Kopp, III	Vice President
Rick L. Barrett	Secretary

Conflict of Interest

The Company has created a conflict of interest policy, whereby all directors, officers and key employees are required to sign conflict of interest disclosure statements on an annual basis. The signed conflict of interest disclosure statements were reviewed for the examination period. No significant conflicts or exceptions were noted.

Corporate Records

A review was made of the Articles of Incorporation and Bylaws of the Company for the period under examination. The Articles of Incorporation and Bylaws were not amended during

the examination period. However, as noted in the two prior examinations, changes to the Company's Bylaws were approved in an August 26, 1996, shareholder's meeting. The approved changes required only one of the individuals appointed to the Executive Committee be a member of the Board of Directors and removed language requiring the President to be a member of the Board of Directors. The Bylaws have never been restated or amended to reflect these changes. The Company should determine whether it intends for the changes noted in the August 1996 shareholder meeting to be incorporated into the Bylaws. If so, the Bylaws should be amended to reflect the approved changes. If not, the changes should be rescinded by an action of the sole shareholder.

The minutes associated with the Company's Board of Directors' meetings and the Written Consents of the Sole Shareholder were reviewed for the period under examination. It was noted the minutes and consents did not properly reflect and approve all material corporate transactions and events of the Company, such as the transfer in ownership of the Company to First Continental. As indicated in the prior full scope financial examination, the Company is once again directed to ensure that all material corporate transactions and events of the Company are brought to the attention of and approved by the shareholder and/or Board of Directors in a timely manner and properly documented in the corporate minutes.

Acquisitions, Mergers and Major Corporate Events

Effective August 31, 2004, Dental Economics, LP, the parent of DSMK, acquired First Continental Life & Accident Insurance Company, a Utah domiciled life insurance company, which was redomiciled to the State of Texas immediately upon acquisition. Effective September 8, 2004, the Commissioner of Insurance of the State of Texas issued an order approving the transfer of Dental Economics, LP's interest in DSMK to First Continental. On January 1, 2005,

all 50,000 shares of DSMK's capital stock were transferred to First Continental, and First Continental became the sole direct owner of DSMK with Dental Economics, LP remaining the direct parent of First Continental.

Surplus Debentures

There were no surplus debentures issued or outstanding for the period under examination.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

As of December 31, 2004, Dental Source of Missouri and Kansas, Inc. was a wholly owned subsidiary of Dental Economics, LP, which in turn is owned by several parties. As of December 31, 2004, the majority ownership interest in Dental Economics, LP was Media Communications Partners III, Limited, which held a 72.45 percent interest. James A. Taylor, an individual, held a 22.75 percent interest. Media Communications Partners III, Limited, the largest shareholder, is a partnership of investors formed in 1996 with primary investment focus directed towards a variety of industries, which include, but are not limited to, telecommunications, information technology services, internet services and radio broadcasting.

As previously indicated in the Acquisitions, Mergers, and Major Corporate Events section of this report, on January 1, 2005, the direct ownership of DSMK was transferred to First Continental Life & Accident Insurance Company. First Continental is a newly acquired affiliate, wholly owned by Dental Economics, LP.

Organizational Chart

The following table partially depicts the holding company system of Dental Source of Missouri and Kansas, Inc. as of December 31, 2004:

<u>Company</u>	<u>Parent or Controlling Entity</u>	<u>Ownership</u>
Dental Economics, LP	Media Communications Partners III, Ltd. James Taylor (an individual) M/C Investors, LLC Dental Economics, LLC	72.45% 22.75% 3.81% 0.99%
Dental Economics, LLC	Dental Economics, LP	100%
Guaranty Assurance Company	Dental Economics, LP	100%
Dental Source of Missouri and Kansas, Inc.	Dental Economics, LP	100%
MNM-1997, Inc. d/b/a OraQuest Dental Plans	Dental Economics, LP Guaranty Assurance Company Dental Source of Missouri and Kansas, Inc.	63% 27% 10%

Intercompany Transactions

During the period under examination, the following intercompany agreement was in force:

Type: Management Contract

Parties: Dental Source of Missouri and Kansas, Inc. and Dental Economics, LLC

Effective: October 1, 1998

Terms: Under the terms and conditions of this agreement, Dental Economics, LLC agrees to provide DSMK with executive management type services, which include, but are not limited to, marketing, accounting, data processing and overall management of the Company. In consideration for the services provided, DSMK agrees to pay Dental Economics, LLC a monthly management fee equal to the greater of \$50,000 or 25 percent of monthly gross revenue.

For the services provided under the Management Contract described above, fees totaling \$957,000, \$965,000 and \$640,000 were incurred and paid by DSMK in the years 2004, 2003 and 2002, respectively.

Effective January 1, 2005, the Management Contract with Dental Economics, LLC was terminated and DSMK entered into a Management Contract with its new direct owner, First Continental. The agreement with First Continental is exactly the same as the prior agreement with Dental Economics, LLC with the exception that the monthly management fee is to be equal to the greater of \$75,000 or 25 percent of monthly gross revenue. For the first quarter of 2005, DSMK paid management fees totaling \$235,000 to First Continental.

As indicated in the last two full scope examination reports, the management fees paid by DSMK to its affiliates appear to be unjustified and unreasonably high due to the following:

1. The specific services provided under the Management Contract could not be justified, nor could the Company's management produce adequate supporting documentation to substantiate any of the management fees incurred by DSMK.
2. The majority of the day-to-day management and administrative functions of DSMK appear to be carried out by employees or consultants of the Company. These functions include billing, premium collection, customer service, sales, agency and brokerage transactions, provider contracting, provider relations, credentialing, quality assurance and information systems maintenance.

Although the fees that were paid by DSMK were less than the maximum amount allowed in accordance with the terms of the Management Contracts, the overall effect of the management fees incurred was to allow the profits of DSMK to be removed to the common owners of Dental Economics, LLC and First Continental, which for the most part are under the same ownership as Dental Economics, LP.

As directed in the previous two examination reports, the Company is once again directed to amend the Management Contract for the purpose of lowering the management fee to a level

that will more reasonably compensate its affiliates for services provided or revise the contract to better illustrate the services provided and supply evidence that such services are indeed provided.

An outside vendor is utilized for the processing and payment of payroll for all of the companies within the Dental Economics group. Prior to 2005, DSMK reimbursed the outside vendor directly for the vendor's administrative fees and for actual payroll expenses. In January 2005, the payroll processing was consolidated to where Dental Economics, LLC reimburses the vendor for the actual employee payroll and pays the administrative fees for all of the companies within the group. Each of the individual companies, including DSMK, then reimburses Dental Economics, LLC for their share of the actual employee payroll. However, DSMK does not reimburse Dental Economics, LLC for any of the administrative fees since these are considered to be covered under the Management Contract DSMK has with First Continental. There is no written agreement between DSMK and Dental Economics, LLC relating to the payroll processing arrangement. Although, the only amounts paid by DSMK to Dental Economics, LLC appear to be direct reimbursement of the payroll expenses paid by Dental Economics, LLC on behalf of DSMK, the Company should still obtain a written agreement for this arrangement.

FIDELITY BOND AND OTHER INSURANCE

DSMK is a named insured on a crime plus policy providing crime and fidelity coverage with a total liability limit of \$500,000 and a \$5,000 deductible. The level of coverage complies with the minimum amount of fidelity insurance required under Section 354.705 RSMo (Qualifications) and with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Company is also a named insured on various other policies providing property, general liability and workers' compensation coverage. However, as indicated in the prior two

full scope examination reports, the Company has not acquired directors' and officers' liability or errors' and omissions' liability insurance coverage to protect itself from potential claims which could occur. Therefore, it is once again recommended the Company immediately acquire directors' and officers' liability and errors' and omissions' liability insurance coverage to adequately protect itself from potential claims.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of December 31, 2004, DSMK had eight employees. The employees of the Company are provided standard employee benefits, which include, but are not limited to, group health insurance, life and accidental death and dismemberment insurance, dental insurance, a 401(k) plan and paid vacation and sick leave.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of December 31, 2004, as reflected below, were sufficient in par and fair value to meet the deposit requirement for the state of Missouri in accordance with Section 354.707 RSMo (Capital and surplus requirements; deposit required).

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
U.S. Treasury Note	\$206,000	\$203,961	\$204,986

Deposits with Other States

The Company also has funds on deposit with the state of Kansas. Those funds on deposit as of December 31, 2004, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
Certificate of Deposit	\$75,000	\$75,000	\$75,000

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Company is licensed by the Missouri Department of Insurance under Chapter 354 RSMo, (Health Services Corporation-Health Maintenance Organizations-Prepaid Dental Plans), to offer prepaid dental plans to organizations and/or individuals desiring such services. The prepaid dental plans of DSMK are an alternative approach to the fee-for-service method of reimbursing dentists for services rendered. It is a system by which specific predetermined dental services are provided to eligible subscribers by independent dental providers or entities contracting with the Company who, in turn, are compensated at a fixed per capita rate, usually on a monthly basis. In consideration for the dental coverage provided, the covered or eligible subscriber is required to pay for the coverage through periodic payroll deductions, bank drafts or direct billings. The Company is also licensed in the state of Kansas.

Direct premiums written in 2004, 2003 and 2002 were \$5,071,923, \$5,014,265 and \$4,770,102, respectively.

Marketing

DSMK focuses its efforts on servicing individual and group subscribers with the following dental plans:

<u>Dental Plan</u>	<u>Plan Features</u>
<ul style="list-style-type: none"> Individual Dental Healthcare Program 	This plan is designed to meet the dental care needs of the individual. Under this program, the individual member is permitted to receive

specific predetermined dental services from a dentist participating within the Company's network of providers. Co-payments are determined in accordance with the plan's schedule of benefits and are paid directly to the provider at the time of service. There is no deductible that applies before coverage can begin and there is no coverage outside of the DSMK Source network.

- **Senior Dent Mobile Dental Plan**

This plan is designed specifically to meet the dental care needs of those eligible members who are residents of living care facilities. Under this plan, the participating provider agrees to come directly to the care facility to provide dental service to the eligible member. All dental services that are provided and the applicable out-of-pocket expenses incurred are in accordance with the summary of dental benefits.
- **Dental Health Maintenance Organization (DHMO)**

The features of this plan are similar to the Individual Dental Healthcare Program, except this plan is intended for group subscribers and requires the enrollment of a minimum of three subscribers per group. Members are required to select a dental provider at the time of enrollment.
- **Free Access Plan (FAP)**

The features of this plan are similar to the DHMO, except under this plan members are not required to select a dental provider at the time of enrollment and are eligible for services with all providers within the DSMK network.
- **Dental Source Companion Plan**

This is a plan in which Companion Life, an unaffiliated entity, and DSMK have elected to pool their efforts to offer a dual option comprehensive dental plan to groups. Under the Companion plan, there are no network restrictions. Each subscribers is given the option of using the dentist of his or her choice. In addition, basic and major services are subject to a combined lifetime deductible of \$100 per person and a maximum calendar year benefit of \$1,200 per person, excluding orthodontic services. The Companion plan is offered in

conjunction with the DHMO plan and requires a minimum enrollment of three subscribers per group in the DHMO plan and the enrollment of at least two subscribers per group in the Companion plan.

The Company's products are marketed through a combination of internal sales staff and a network of independent agents and brokers. The Company's advertising efforts are limited to random mailings to prospective groups and the distribution of informational brochures to prospective members.

The Company has a standard agent agreement, which is to be completed for all agents and brokers who sell the Company's products. It was noted that the Company did not have written agreements for several of its active agents. Furthermore, in the one instance where the Company was able to provide a written agreement, it was noted the Company was paying a different commission rate than the rate stated in the agreement. The Company should ensure that written agent agreements are obtained for all agents and brokers who market the Company's products, and that the provisions of agent agreements are followed.

Provider Contracts

In order to provide the services associated with the dental plans mentioned, the Company maintains the following types of provider agreements: Dentist Contract, Dentist FAP Contract, Specialist Contract and Specialist FAP Contract. It was noted the Dentist FAP Contract and Specialist FAP Contract were not filed with the Missouri Department of Insurance as required by Missouri Regulation 20 CSR 400-8.200 (Procedures for the Filing of All Policy Forms and Certain Rates for Life or Health Policies, Contracts or Related Forms). The Company is directed to ensure that all policies, contracts and related forms are filed with the MDI in accordance with Missouri Regulation 20 CSR 400-8.200.

Grievance Procedures

As required by Section 354.715 RSMo (Service contracts: complaint procedures), the Company has established a policy to handle grievances and complaints filed by its enrollees. This policy is communicated to all members on an annual basis.

Provider Credentialing and Quality Assurance

The Company performs periodic credentialing and quality reviews of its providers and discusses all findings with the respective provider. A credentialing review is performed every two years for the purpose of reviewing the provider's dental license, insurance coverage and controlled substance certification and registration. The areas reviewed under a quality review are the facilities of the provider, patient safety, infection control practices, dental health records, patient treatment and access to care.

REINSURANCE

The Company does not engage in any assumed or ceded reinsurance transactions.

ACCOUNTS AND RECORDS**Independent Auditor**

The Company's financial statements were audited by the CPA firm of BDO Seidman, LLP, of Houston, Texas for each of the years in the examination period.

Independent Actuary

The actuarial assumptions and methods used by the Company in determining unpaid claim reserves, actuarial liabilities and other related actuarial items were reviewed and certified by Donna D. Allen, MAAA, FSA, EA of Signature Optimal Solutions, of Huntington Beach, California for each of the years in the examination period.

Custodial Agreements

During our review of the Company's cash and investment accounts, it was noted that the Company's custodial agreements with Central Bank and with Commerce Bank did not contain all of the safeguard provisions specified in Part 1, Section IV of the NAIC Financial Condition Examiners Handbook. The Company should amend or restate the custodial agreements so that they contain all of the NAIC specified safeguard provisions. Until such time as the agreements are brought into compliance with NAIC guidelines, they should be disclosed in General Interrogatory 23.02 of the Annual Statement relating to custodial agreements that do not comply with NAIC guidelines.

Companion Life Advance Premiums

Under its Administrative Agreement with Companion Life, DSMK collects all premiums related to the Companion plan from subscribers and then transfers the premiums, less the DSMK commission, to Companion Life. The Company included the advance premiums received on behalf of Companion Life with its own advance premiums reported on the "Premiums received in advance" line of the Annual Statement. Per SSAP No. 67, amounts received and held in a fiduciary capacity are to be reported on the "Amounts withheld or retained for others" line of the Annual Statement. As the Administrative Agreement the Company has with Companion Life

states that all premiums received by DSMK are to be deemed funds of Companion Life, the advance premium amounts, less any commissions due to DMSK, should be reported on the “Amounts withheld or retained for others” line of the Annual Statement. Although the amount of the Companion Life advance premiums, which should be reclassified, is considered material for our examination purposes, an examination change will not be made since such a reclassification would not effect DSMK’s ending surplus. However, the Company should ensure that the Companion Life advance premiums are properly reported on future Annual and Quarterly Statement filings.

Escrow Suspense Account

The Company reports partial premium payments received through member payroll deductions in an escrow suspense account until the full amount of the premium is collected, due to the fact that its premium system will not accept partial payments. The escrow suspense account is reported as an aggregate write-in for liabilities on the Annual Statement. Per the NAIC Annual Statement Instructions for Health Companies, cash receipts that cannot be identified for specific purposes, or for other reasons cannot be applied to a specific account when received, are to be reported on the “Remittances and items not allocated” line of the Annual Statement. Although the escrow suspense account is considered material for our examination purposes, an examination change will not be made to reclassify the escrow suspense account, since such a reclassification would not effect DSMK’s ending surplus. However, the Company should ensure that the escrow suspense amounts are properly reported on future Annual and Quarterly Statement filings.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2004, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the financial statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been additional differences found in the course of this examination that are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial in relation to the financial statements, and therefore were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

ASSETS			
	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	\$ 278,961	\$ -	\$ 278,961
Common Stocks	50,000	50,000	-
Cash and short-term investments	774,406	-	774,406
Investment income due and accrued	3,399	-	3,399
Uncollected premiums and agents' balances in the course of collection	60,584	-	60,584
Electronic data processing equipment and software	6,030	282	5,748
Furniture and equipment	4,212	4,212	-
Aggregate write-ins for other than invested assets:			
Acquisition costs-Safeguard	12,208	-	12,208
Receivable-Huff post acquisition	46	46	-
Rental deposits	3,700	3,700	-
Total Assets	\$ 1,193,546	\$ 58,240	\$ 1,135,306

LIABILITIES, CAPITAL AND SURPLUS	
Claims unpaid	\$ 158,889
Premiums received in advance	441,284
General expenses due and accrued	71,740
Current federal & foreign income tax payable and interest thereon	5,083
Amounts withheld or retained for the account of others	33,255
Aggregate write-ins for other liabilities:	
Retainers payable	63,459
Escrow suspense	15,943
Other liabilities	721
Total Liabilities	\$ 790,374
Common capital stock	\$ 50,000
Gross paid in and contributed surplus	174,294
Unassigned funds (surplus)	120,638
Total Capital and Surplus	\$ 344,932
Total Liabilities, Capital and Surplus	\$ 1,135,306

STATEMENT OF REVENUE AND EXPENSES

Net premium income	\$ 5,071,923
Total Revenue	5,071,923
Hospital and Medical:	
Other professional services	2,955,155
Subtotal	2,955,155
General administrative expenses	2,201,997
Total underwriting deductions	\$ 5,157,152
Net underwriting gain or (loss)	\$ (85,229)
Net investment income earned	7,886
Aggregate write-ins for other income or expenses:	
Provider network fees	43,570
Administrative fees	68,278
Net income before federal & foreign income taxes	\$ 34,505
Federal and foreign income taxes incurred	\$ 8,230
Net income	\$ 26,275

CAPITAL AND SURPLUS ACCOUNT

Capital and surplus, prior reporting year	\$	309,016
Net income or (loss)		26,275
Net unrealized capital gains and losses		(1,026)
Change in nonadmitted assets		10,667
Net change in capital and surplus for the year	\$	35,916
Capital and surplus, December 31, 2004	\$	344,932

NOTES TO FINANCIAL STATEMENTS

None.

EXAMINATION CHANGES

None.

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Corporate Records

Page 9

The Company should determine whether it intends for the changes noted in the August 1996 shareholder meeting to be incorporated into its Bylaws. If so, the Bylaws should be amended to reflect the approved changes. If not, the changes should be rescinded by an action of the sole shareholder.

The Written Consents of the Sole Shareholder and Board of Directors' meeting minutes did not properly reflect all material corporate transactions and events of the Company, such as the transfer in ownership of the Company to First Continental. As indicated in the prior full scope financial examination, the Company is once again directed to ensure that all material corporate transactions and events of the Company are brought to the attention of and approved by the shareholder and/or Board of Directors in a timely manner and properly documented in the corporate minutes.

Intercompany Transactions

Page 12

The management fees paid during the examination period appear to be unjustified and unreasonably high. As recommended in the previous two examination reports, the Company is once again directed to amend the Management Contract for the purpose of lowering the management fee to a level that will more reasonably compensate its affiliates for services

provided or revise the contract to better illustrate the services provided and supply evidence that such services are indeed provided.

There is no written agreement between DSMK and Dental Economics, LLC relating to the payroll processing services performed by Dental Economics, LLC. Although, the only amounts paid by DSMK to Dental Economics, LLC appear to be for direct reimbursement of payroll expenses paid by Dental Economics, LLC on behalf of DSMK, the Company should still obtain a written agreement for this arrangement.

Fidelity Bond and Other Insurance

Page 14

As indicated in the prior two full scope examination reports, the Company has not acquired directors' or officers' liability and errors' and omissions' liability insurance coverage to protect itself from potential claims. Therefore, it is once again recommended the Company immediately acquire directors' and officers' liability and errors' and omissions' liability insurance coverage to adequately protect itself.

Marketing

Page 18

The Company did not have written agreements for several of its active agents. Furthermore, in the one instance where the Company was able to provide a written agreement, it was noted the Company was paying a different commission rate than the rate stated in the agreement. The Company should ensure that written agent agreements are obtained for all agents and brokers who market the Company's products, and that the provisions of agent agreements are followed.

Provider Agreements

Page 18

The Dentist FAP Contract and Specialist FAP Contract were not filed with the Missouri Department of Insurance as required by Missouri Regulation 20 CSR 400-8.200 (Procedures for

the Filing of All Policy Forms and Certain Rates for Life or Health Policies, Contracts or Related Forms). The Company is directed to ensure that all policies, contracts and related forms are filed with the MDI in accordance with Missouri Regulation 20 CSR 400-8.200.

Custodial Agreements

Page 20

The custodial agreements with Central Bank and with Commerce Bank did not contain all of the safeguard provisions specified in Part 1, Section IV of the NAIC Financial Condition Examiners Handbook. The Company should amend or restate the custodial agreements so that they contain all of the NAIC specified safeguard provisions. Until such time as the agreements are brought into compliance with NAIC guidelines, they should be disclosed in General Interrogatory 23.02 of the Annual Statement relating to custodial agreements that do not comply with NAIC guidelines.

Companion Life Advance Premiums

Page 20

The Company included the advance premiums received on behalf of Companion Life with its own advance premiums reported on the “Premiums received in advance” line of the Annual Statement. Per SSAP No. 67, amounts received and held in a fiduciary capacity are to be reported on the “Amounts withheld or retained for others” line of the Annual Statement. As the Administrative Agreement, the Company has with Companion Life states that all premiums received by DSMK are to be deemed funds of Companion Life, the advance premium amounts, less any commissions due to DMSK, should be reported on the “Amounts withheld or retained for others” line of the Annual Statement. The Company should ensure that the Companion Life advance premiums are properly reported on future Annual and Quarterly Statement filings.

The Company reports partial premium payments received through member payroll deductions in an escrow suspense account until the full amount of the premium is collected, due to the fact that its premium system will not accept partial payments. The escrow suspense account is reported as an aggregate write-in for liabilities on the Annual Statement. Per the NAIC Annual Statement Instructions for Health Companies, cash receipts that cannot be identified for specific purposes, or for other reasons cannot be applied to a specific account when received, are to be reported on the “Remittances and items not allocated” line of the Annual Statement. The Company should ensure that the escrow suspense amounts are properly reported on future Annual and Quarterly Statement filings.

SUBSEQUENT EVENTS

As indicated in the Acquisitions, Mergers and Major Corporate Events and in the Intercompany Transactions sections of this report, effective January 1, 2005, the ownership of DMSK was transferred from Dental Economics, LP to First Continental Life and Accident Insurance Company. Concurrent with the transfer of ownership, the Management Contract between DSMK and Dental Economics, LLC was terminated and a new Management Contract was entered into between DSMK and First Continental. First Continental is a wholly owned subsidiary of Dental Economics, LP.


ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and employees of Dental Source of Missouri and Kansas, Inc. during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Barbara Bartlett, CPA, AFE, and Andy Balas, CFE, examiners for the Missouri Department of Insurance, participated in this examination.

VERIFICATION

State of Missouri)
) ss
County of Cole)

I, Mark Nance, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.



Mark Nance, CPA, CFE
Examiner-in-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this 15 day of Sept., 2005.

My commission expires: 5-20-2006

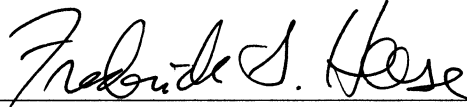


Notary Public

BEVERLY J. GREGORY
Notary Public - State of Missouri
Cole County
My Commission Expires: May 20, 2006

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

A handwritten signature in black ink, reading "Frederick G. Heese", written over a horizontal line.

Frederick G. Heese, CFE, CPA

Audit Manager

Missouri Department of Insurance

November 14, 2005

Mr Fred Heese
Missouri Department of Insurance
615 E. 13 St.
Kansas City, MO 64106

RECEIVED
MO INS DEPT
NOV 21 2005

Dear Heese,

This letter is in response to the Missouri Department of Insurance's General Comments and/or Recommendations section of the Examination Report for the period ending December 31, 2004 that Dental Source of Missouri and Kansas, Inc. (DSMK) will act upon. Please incorporate our response with the Examination Report of DSMK for the period ending December 31, 2004.

DSMK will take the following action:

1. Corporate Records (Page 9)

DSMK will ensure that all material corporate transactions and events of DSMK will be properly approved by the Board of Directors in a timely manner. The transfer of ownership to First Continental Life & Accident Insurance Company will be documented in the Corporate minutes.

2. Intercompany Transactions (Page 12)

The Management of DSMK does not agree with the Department's recommendation for DSMK to amend the Management Contract for the purposes of lowering the management fee. The Management fee agreement was set at the higher of 25% of gross revenue or \$50,000 (\$75,000 effective 1/1/2005) as a ceiling in which management of the parent company would be compensated for the services performed on behalf of DSMK. Dental Economics and First Continental Life & Accident Insurance Company effective 1/1/2005, parent company, personnel have spent and continue to spend an extraordinary amount of time and resources with respect to the management of the company and believe the management fees paid by the company to its parent are fair and reasonable. The President of Dental Source (James A. Taylor) and Secretary (Rick Barrett) provide management of the marketing and operational areas of DSMK on a continuing basis with no direct salary compensation. Accounting and administrative functions for Dental Source have been and will continue to be provided by the parent company. These tasks include but are not limited to the monthly, quarterly and annual reporting requirements presented to internal management, the board of directors and the Department of Insurance, payroll and benefits administration; and payment of general expenses. Also travel costs to

and from Kansas City have been incurred to provide supervision for staff and implement and maintain the billing system that commenced in January of 2000.

In addition, the Management of DSMK will diligently take into consideration the profitability and related net worth requirements of the State of Missouri each year to ensure fees are reasonable to safely remain within the statutory requirements as it relates to capital and surplus. DSMK has greatly improved its' financial condition and currently far exceeds the capital and surplus requirement for Pre-Paid Dental Plans. The capital and surplus attained by DSMK of \$344,932 represents a substantial increase of the capital and surplus of \$225,127 reported on the December 31, 2001 Missouri Department of Insurance State audit report for DSMK.

The payroll processing services performed by the parent company for the benefit of DSMK are part of the Management Contract reflected above while the direct reimbursement of payroll expenses incurred by DSMK personnel are documented in the payroll records.

3. Fidelity Bond and Other Insurance (Page 14)

The Department has recommended DSMK acquire directors' or officers' liability and errors' and omissions' liability coverage to protect itself from potential claims. DSMK has received quotes from various carriers for such insurance and DSMK has determined the cost of such a policy for a company our size and risk category would not be beneficial at this time. DSMK will continue to monitor the associated cost in relation to the benefits received going forward to potentially acquire this insurance in the future.

4. Marketing (Page 18)

DSMK has updated its agents' records to ensure that written agent agreements are obtained for all agents and brokers who market DSMK's products, and that the provisions of agent agreements are followed.

5. Provider Agreements (Page 18)

DSMK will ensure that all current and future policies, contracts and related forms are filed with the Missouri Department of Insurance in accordance with Missouri regulations.

6. Custodial Agreements (Page 20)

DSMK is currently in communication with the financial institutions where custodial agreements are in place. DSMK, in conjunction with these financial institutions, will work to amend or restate the custodial agreements in order to comply with updated NAIC specifications.

7. Companion Life Advance Premiums (Page 20)

DSMK have restated advance premiums received on behalf of Companion Life to the "Amounts withheld or retained for others" line on the 2005 2nd quarter Statutory

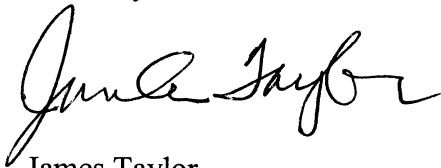
Statement filing and all future filings. This reclassification is solely a recommended change in the reporting category of the liability and has no net effect on the statutory net worth of DSMK.

8. Escrow Suspense Account (Page 21)

DSMK have restated partial premium payments received through member payroll deductions in an escrow suspense account to the "Remittances and items not allocated" line on the 2005 2nd quarter Statutory Statement filing and all future filings. This reclassification is solely a recommended change in the reporting category of the liability and has no net effect on the statutory net worth of DSMK.

Please feel free to contact us regarding any questions you may have concerning these items.

Sincerely,



James Taylor
President